MACROPRUDENTIAL RECOMMENDATION WITHIN THE LEGAL FRAMEWORK OF NEW CREDIT AGREEMENTS FOR CONSUMERS: convergence of the average maturity of new credit agreements for house purchase towards 30 years

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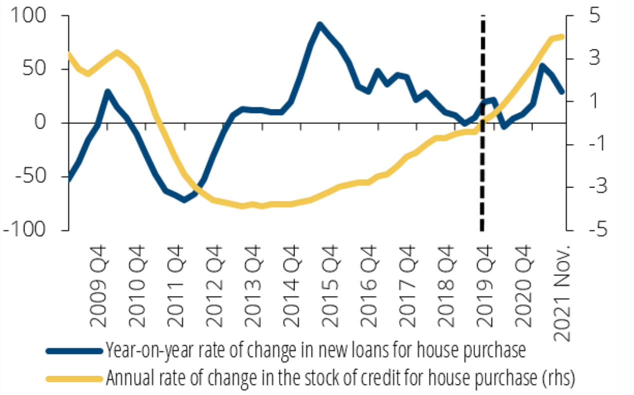
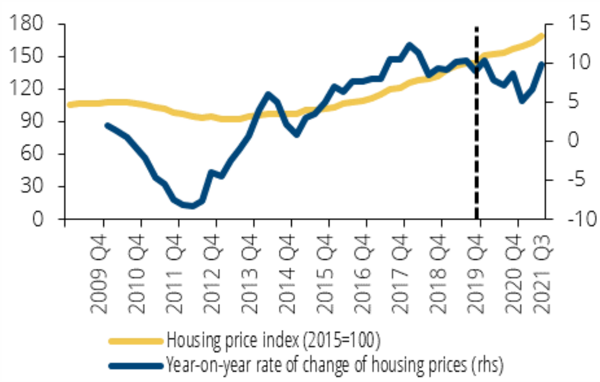
Loans for house purchase and residential property prices have remained on a growth trend over the past two years, despite the pandemic crisis. In a context of low interest rates and labour market resilience, largely linked to the support measures put in place to mitigate the effects of the pandemic crisis, the annual rate of change in the stock of credit for house purchase increased from 0.1% at the end of 2019 to 4% in November 2021. The year-on-year rate of change in new credit for house purchase followed a similar trend, increasing by 29% in the quarter ending in November 2021 (19.8% in the last quarter of 2019) (Chart 1). Housing prices also continued to increase during the pandemic. The growth rate of housing prices declined from 10.3% in the first quarter of 2020 to 5.2% in the first quarter of 2021. However, the second and third quarters of 2021 saw a further rise in housing price growth, by 6.6% and 9.9% respectively compared to the same period a year earlier (Chart 2).

Chart 1 • Annual rate of change in the stock of credit for house purchase and year-on-year rate of in new loans for house purchase | Per cent



Source: Banco de Portugal. | Note: The annual rate of change was adjusted for securitisation operations, reclassifications, write-offs, price and exchange rate revaluations and, where relevant, for the effect of securitisation and sales.

Chart 2 • Trend of housing prices | Per cent



Source: Statistics Portugal (Banco de Portugal calculations).

Domestic bank credit has not been the main factor behind the rise in housing prices. The shortage of supply and housing demand from non-residents and for investment, in an environment of low interest rates, have contributed to the rise in residential property prices in Portugal. In addition, the share of residential property transactions financed by domestic credit has remained relatively stable at around 43% since 2017, i.e. significantly lower than in the period prior to the sovereign debt crisis (66% in 2009). In the current context, it is important to ensure that credit for house purchase does not become a determinant in residential property price developments, thus preventing the creation of a spiral between credit and prices in this market. By imposing limits on LTV[1] and DSTI[2] ratios and to maturity,[3] the macroprudential Recommendation has helped

[1] The LTV (loan-to-value) ratio is the ratio of the loan amount to the minimum between the purchase value and the appraisal value of the immovable property pledged as collateral.

[2] The DSTI (debt service-to-income) ratio corresponds to the ratio of the total amount of monthly instalments of a borrower's total debt to his/her income. The DSTI considers at the numerator level the impact of an interest rate rise and at the denominator level a reduction of the income in the case of borrowers aged 70 and over at the expiry of the agreement.

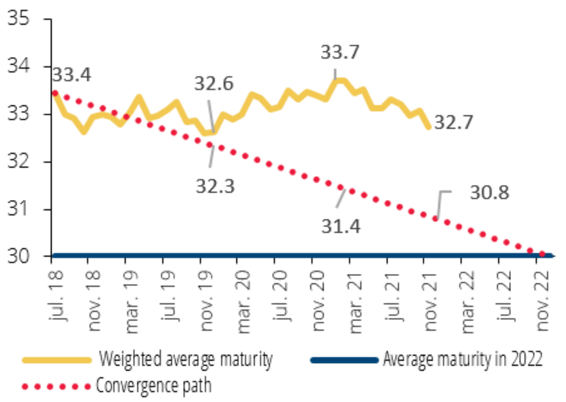
[3] In addition to setting out a maximum maturity of 40 years for credit for house purchase, the macroprudential Recommendation establishes gradual convergence of the average maturity of new agreements towards 30 years by the end of 2022.

to mitigate the interaction between real estate prices and the credit cycle and to improve the risk profile of borrowers, thus contributing to the resilience of the banking system.

Credit institutions have broadly complied with the guidelines set out in the macroprudential Recommendation relating to new credit for house purchase and consumer credit. Nevertheless, the average maturity of new loans for house purchase has not undergone linear and gradual convergence towards 30 years.[4] Between July 2018 and December 2019 the average maturity of new credit for house purchase declined by around one year. However, between December 2019 and January 2021 there was an increase to 33.7 years. Despite the reduction seen since then, in November 2021 the average maturity (32.7 years) was significantly above the path of convergence towards 30 years (Chart 3). In addition, the average maturity of credit for house purchase in Portugal remains somewhat high compared to other European Union countries. In the group of European Union countries for which information is available, Portugal stands out as an outlier, with an average maturity of around 33 years in 2020 (compared with maturities between 20 and 27 years in the other countries) and an upper limit to maturity of 40 years (Chart 4).

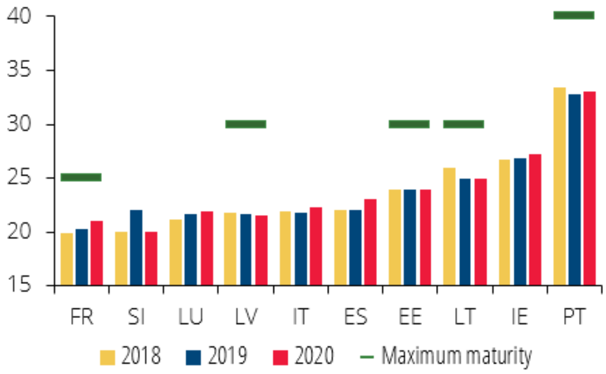
The adoption of limits to the original maturity of loans is aimed at: (i) avoiding that limits to the DSTI ratio are circumvented by the extension of the loan maturity; (ii) easing the extension of the maturity and the restructuring of the loan in the event of borrowers' arrears, potentially reducing default; and (iii) reducing the divergence from the average maturity of new credit agreements for house purchase in other European Union countries.

Chart 3 • Weighted average maturity of new loans for house purchase | In years



Source: Banco de Portugal. | Note: This chart is based on information reported by nine institutions, which together account for around 96% of the housing credit market.

Chart 4 • Annual average maturity of new credit for house purchase by country | In years



Source: Information published by the respective national authorities. | Note: In addition to Portugal, Malta is the only European Union country which to date has a maximum maturity of 40 years.

Given the strong concentration of new credit for house purchase in longer maturities, the Banco de Portugal considers that the maximum maturity of new business should be reduced to contribute to the gradual and linear convergence of the average maturity of new credit agreements for house purchase towards 30 years by the end of 2022. Hence, with effect from 1 April 2022 the Banco de Portugal recommends the following limits to the original maturity of these loans: 40 years for borrowers aged 30 or under; 37 years for borrowers aged over 30 and up to and including 35; and 35 years for borrowers aged over 35.

The Banco de Portugal, as the macroprudential authority, will continue to monitor compliance with the Recommendation, to prevent potential distortions of competition or actions that may jeopardise the Recommendation's effectiveness. The Banco of Portugal may adopt additional measures to achieve the purpose of convergence of the average maturity of new credit agreements for house purchase towards 30 years, where necessary.

[4] On compliance with the guidelines set out in the macroprudential Recommendation relating to new credit for house purchase and consumer credit, see Chapter 1.4 Macroprudential Policy of the December 2021 *Financial Stability Report*.